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SUBJECT: EL SALVADOR: IMPACT OF RISING FOOD/AGRICULTURAL COMMODITY PRICES

REF: A) STATE 39410
B) SAN SALVADOR 479

¶11. (U) Per reftel A tasker, Post's responses on the impact of rising food prices are categorized below.

Demand

¶12. (U) The main staples of the population are small red kidney beans, white corn tortillas, and, to a lesser extent, rice. Wheat is used in the production of artisan bread consumed in urban areas, but it has a more elastic demand.

¶13. (U) El Salvador is a net food importer. It is self-sufficient in white corn production but sources most of its grains from other Central American countries and the United States. El Salvador imports annually around 80,000 metrics tons of rice, mostly from the United States, and 350,000 quintals of beans, mostly from Nicaragua.

There have been shortages of red kidney beans in the past few months when Nicaragua suspended exports to El Salvador, and there are projections of a smaller crop of red kidney beans in Nicaragua for August 2008, which would decrease Nicaraguan exports to El Salvador. The smaller red kidney beans that Salvadorans demand are supposedly grown only in El Salvador, Nicaragua and Honduras.

¶14. (U) Over the last year (March 2007- March 2008), local wholesale prices of white corn have increased by 19.4% (to \$17 per quintal), local wholesale prices of red kidney beans increased by 82%, local wholesale prices of rice grew by 64.6%, and local wholesale prices of sorghum increased 47.2%. According to the Ministry of Agriculture, the price of white corn could reach \$20 per quintal within a couple weeks. Higher input costs are also affecting prices of dairy and poultry products. Retail prices of poultry increased by 13%, eggs (per 30-unit container) increased by 12%, fluid milk increased by 25%, and artisan cheese (per pound) increased by 18.4%.

¶15. (U) There has not been a shift in consumption towards alternative commodities, only a reduction in the consumption of basic goods. The World Food Program reports that, as a result of higher food prices, the caloric intake of an average meal in rural El Salvador is roughly 60% of what it was in May 2006. Rural poor involved in subsistence agriculture are buffered against higher prices; the

non-agricultural rural poor are hardest hit, followed by the urban poor.

Supply

¶ 6. (U) The Ministry of Agriculture (MAG) projects an increase in the production of basic grains for 2008. Over the last three years, domestic production of beans, sorghum, white and yellow corn has increased but it has not been enough to meet internal demand. The government of El Salvador does not keep high food inventories and does not currently have a strategic reserve program. The MAG estimates that the post-harvest losses due to a lack of storage facilities range between 7 and 25 percent of the total crop. At present, local officials report no problem with the availability of food.

¶ 7. (U) Higher fertilizer prices are negatively affecting production, especially by small producers. The price of ammonium sulphate (100 kilos) grew by 82.3%, while the price of urea 46 (150 pounds) grew by 34% from March 2007–March 2008.

¶ 8. (U) El Salvador plans to introduce an Ethanol Law that will establish a mandatory mixture of at least 10 percent ethanol. This is not expected to affect national food production, since the current production of molasses and sugar is more than enough to cover future ethanol production. Even if the law mandates a 20 percent mixture, idle land suitable primarily for sugar or cotton, not food land, would be used for new production.

Political Impact

¶ 9. (U) There have already been several protests this year by small bakery owners because of the high cost of wheat flour. Spurred by high energy prices, bus companies are seeking more subsidies and/or

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tariff increases and they too have threatened to strike. As in the case of food prices, it is the poor who will suffer the most from an increase in bus fares. Combined with fears of the impact of a U.S. recession on El Salvador, President Saca and others have described the situation as a perfect storm, prompting Saca to address the nation on April 28 on the state of the Salvadoran economy. Higher prices and the resulting economic impact are also expected to be significant issues the January/March 2009 Legislative and Presidential elections (ref B).

Economic Impact

¶ 10. (U) Food (and energy) prices are affecting both inflation and growth forecasts. The annual inflation rate in March reached 6%, the highest figure reported in March since 1998. Food prices showed an annual inflation rate of 9.2%. The International Monetary Fund (IMF) has dropped its GDP growth forecast for El Salvador to 3% GDP for 2008, while the government lowered the official growth projection from 4.5% to 4%.

¶ 11. (U) The greatest effect will be felt by the poor, who commit around 50 percent of their income to food, and by households in extreme poverty. Approximately 165,000 households living in extreme poverty will not be able to satisfy their food basic needs.

Environmental Impact

¶ 12. (U) Thus far, there has not been a noticeable environmental impact. Higher fuel prices, however, have started to affect the price of propane (cooking) gas. Propane gas has been subsidized by the government since 1996, and it is about half of the average gas price in the rest of Central America. While the government announced a 23 percent price increase earlier this month, Saca said in his April 28 speech that propane gas subsidies will continue. Higher gas prices could lead to a higher consumption of firewood for cooking, with a corresponding negative effect on deforestation, erosion, and water availability.

Government Policy Response

¶ 13. (U) Because of the current crisis, the Ministry of Agriculture

plans to start building food silos, and will invest around \$15 million this year to build between 37 and 50 thousand 1-metric ton silos. These silos will be used small producers that own less than one hectare, and MAG will hire between 250 and 4000 students to teach small producers to make efficient use of the silos. MAG expects the silos to be completed by August or September 2008, in time for the next grain harvest.

¶14. (U) MAG has also announced a series of assistance programs. Under the main program, MAG is offering small farmers a supply of higher yield certified seeds and fertilizer to increase local production of white corn, sorghum, beans, rice, pasture, and vegetables. In the 2008 General Budget, the government has allocated an additional \$10 million to MAG's budget to cover this seed/fertilizer giveaway program. The program will cover 243,000 hectares (including 189,000 hectares of corn and 24,000 hectares of beans) and 420,300 small producers. MAG is promoting increased rice production through the use of hybrid seed. MAG is also providing certified pasture seed to offset the higher costs of feed mixes for livestock producers. MAG, together with the Environmental Ministry, will send a special regulation on genetically modified organisms to the Presidency for its approval. This regulation will allow the use of higher yield and more resistant seeds in order to increase food productivity.

¶15. (U) Last year, the GOES negotiated a minimum wage increase with the private sector, to be carried out in two tranches (November 2007 and November 2008). Because of higher prices, the GOES proposed the private sector accelerate the second tranche. The Maquila sector already approved the increase for May 2008, and the rest of the private sector is likely to follow by May or June 2008.

¶16. (U) The GOES eliminated the 10 percent tariff for wheat flour and is investigating whether the two flour distributor companies have agreements that limit competition in the market. The Ministry of Economy also launched a special credit line for small artisan bread producers with a 10% interest rate for loans up to \$400,000 with a six month grace period for capital payment if the loan is used to purchase equipment. The government is also promoting the approval of a Leasing Law that will encourage a greater use of land for basic grains production. This Leasing Law has been at the Legislative Assembly since July 2005, but it only now has enough

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support to pass.

¶17. (U) The Minister of Economy announced a series of measures aimed to protect the most vulnerable groups. They include adding between 10 and 23 additional municipalities ahead of schedule to the anti-poverty program "Red Solidaria," which supports poor rural households with conditional cash subsidies, improved social services, and access to micro-credit. The Minister also announced an enlargement of the program "Escuela Saludable" (Healthy School) which provides free lunches to school kids. They will expand coverage from preschool and primary school to up to ninth grade in 240 municipalities in the country. They also want to include the urban areas of San Salvador and add milk to the food supplied by the program.

¶18. (U) At the GOES's request, President of Colombia Alvaro Uribe stated that he will negotiate with Colombian producers the provision of 6,000 tons of red kidney beans for the Salvadoran market. The GOES has also begun searching for land outside of the country for growing red kidney beans, white and yellow corn, and rice. They have had talks with Belize and Panama, and President Saca stated that Guatemala, Honduras and Nicaragua have also offered their land as part of a regional plan to guarantee the supply of basic grains.

Impact on Post Programs

¶19. (U) Post does not anticipate any effect on post programs at this time. Though, the Saca administration has requested assistance from the Inter-American Development Bank on its debt service payments to put towards food assistance programs. In addition, concerns (realistic or not) about crops going to ethanol production instead of food production might cause the GOES to postpone its biofuels

initiatives. El Salvador is one of the pilot countries in the U.S.-Brazil Alternative Energy Initiative.

Policy Proposals

¶20. (SBU) For the GOES, Post would encourage programs aimed at increasing post-harvest storage capacity, which would help reduce post-harvest crop loss and related temporary food shortages. Other measures the government could take to lower prices are reducing tariffs and raising tariff-rate quotas on agricultural goods and eliminating or reducing the value-added tax (IVA) on basic foods. Implementing a property tax would also encourage more productive use of land.

¶21. (SBU) At the same time, the GOES must be careful not to develop agriculture too much in response to current prices. When commodity prices eventually drop, El Salvador could have too many resources invested in agriculture to adapt. Similarly, the GOES should avoid implementing politically expedient populist policies (e.g., price controls) that would damage economic growth and reform in the longer term.

¶22. (SBU) The experience of El Salvador shows the damage that agricultural trade barriers can cause, like price spikes when other countries prohibit/inhibit exports. Post would encourage USG policies that promote increased free trade in agricultural products.

Glazer